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In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 1296

BEN F. HOPKINS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The opinion of the Tax Court (R. 95–109) is reported at 5 T. C. 803. The *per curiam* order of the court below (R. 155) is reported at 157 F. 2d 679.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on October 18, 1946. (R. 155.) Taxpayer's petition for rehearing was denied February 6, 1947. (R. 167.) The petition for a writ of certiorari was filed April 28, 1947. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Taxpayer created a trust for each of his two minor sons under which he retained, in addition to other powers, the right to shift the income and corpus as between the sons and the remaindermen. Did the court below err in affirming the Tax Court's decision that taxpayer was taxable on the income of the trusts under Section 22 (a) of the Revenue Acts of 1936 and 1938 and of the Internal Revenue Code?

STATUTES INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

Section 22 (a) of the Revenue Act of 1938, c. 289, 52 Stat. 447, and Section 22 (a) of the Internal Revenue Code (26 U. S. C. 1940 ed., Sec. 22) contain provisions identical with those of the Revenue Act of 1936 above quoted.

STATEMENT

The Commissioner determined deficiencies in taxpayer's income taxes for the year 1936 through 1939, on the ground that the income of two trusts created by taxpayer, one for each of his minor sons, was taxable to him under Sections 22 (a), 166, and 167 of the applicable Revenue Acts and Internal Revenue Code. (R. 8–13.) That determination has twice been reviewed by the courts below. In its first opinion the Tax Court sustained the Commissioner's determination under Section 167 and *Helvering* v. *Stuart,* 317 U. S. 154, and accordingly considered it unnecessary to pass on the applicability of Section 22 (a). (R. 15-21.) Upon appeal the Circuit Court of Appeals held (144 F. 2d 683) that taxpayer was taxable under Section 167 on only so much of the trust income as was equal to sums actually required and used for the support of the minor sons, but remanded the case to the Tax Court with directions to determine whether the entire trust income was taxable to taxpayer under Section 22 (a) and *Helvering* v. *Clifford,* 309 U. S. 331. (R. 137–150.) Upon the remand further evidence was taken (R. 95–96), the Tax Court made a restatement of the findings (R. 96–103), and sustained the Commissioner's determination under Section 22 (a) (R. 103–109). Taxpayer again appealed, the Circuit Court of Appeals affirmed without opinion (R. 155), and taxpayer's

petition for rehearing (R. 159–164) was denied (R. 167).[1]

The relevant facts, as contained in the stipulations and attached exhibits (R. 25–61, 79–94), and as found by the Tax Court (R. 96–103), may be summarized as follows:

On December 31, 1935, taxpayer created two identical trusts, one for each of his minor sons, naming himself and a bank as trustees. The corpus of each trust consisted of 5,000 shares of the common stock of a corporation of which taxpayer was the president and the largest single stockholder. (R. 96–97.) By paragraph 5 of the trust instruments taxpayer reserved the right at any time to remove the co-trustee bank and appoint another bank as successor. (R. 31, 97.) Under paragraph 7 the trustees were given broad management powers, including the power to invest and reinvest trust funds "irrespective of any statutes or rules or practices of Chancery Courts" limiting trust investments, to manage the trust property "as if the absolute owners", and to vote any securities in the trusts. (R. 33, 97–98.) Paragraph 8 empowered the trustees to make loans to taxpayer's executors or to purchase assets of his estate in order to facilitate payment of his

[1] By order of the court below the transcript of record on the first appeal was made part of the record on the second appeal. (R. 153–154.) The printed record incorporates the record on review on both appeals, except for cumulative matters.

estate and inheritance taxes. (R. 35, 100.) Paragraph 9 required the trustees to act unanimously but relieved them of liability, except for fraud or bad faith, "on account of any action taken in which one of the Trustees does not consent or approve". (R. 35–36.) Paragraph 14 empowered the trustees to pay out of corpus premiums on any insurance policies on taxpayer's life made part of the trusts. (R. 37–38, 98.) The trust instruments then provided as follows (R. 98–99):[2]

> 15. The net income from the trust estate shall be accumulated and added to the principal of the trust estate until my son Ben F. Hopkins, Jr. arrives at the age of twenty-one years and thereafter the net income shall be paid to him monthly so long as he lives, provided, however, that so long as I am living and competent to act, there may be and shall be paid to and applied and utilized for my son Ben F. Hopkins, Jr. from the net income and/or principal such sum or sums, and at such time or times, and in such manner as I may, in my sole discretion, deem to be to his best interests. Any income not paid to, nor expended nor utilized for my said son shall be accumulated and added to the principal of the trust estate.
>
> 16. Upon the death of my son Ben F. Hopkins, Jr. the trust estate remaining

[2] Except for the names of the sons the provisions of each trust were the same.

> unconsumed at his death shall vest in and be distributed in such shares and amounts, and in such manner, as my son Ben F. Hopkins, Jr. may appoint by last will and testament or codicil; provided, however, this power must be exercised in favor of one or more of the following, to-wit: My son's widow, the lawful issue of my son's body, my son's mother, and his brothers.

In case of the son's failure to exercise the power confered in paragraph 16, the remainder was to go to his issue or in default of issue to his brothers and their issue (subject to certain rights of the widow of the deceased son), and in default of any living beneficiaries to a certain Foundation. (R. 38, 98–99.) Paragraph 19 provided that the trust was irrevocable but reserved to taxpayer the right to enlarge the powers of the trustees. (R. 40, 99.)

The trust continued in force throughout the taxable years except for a modification in 1939 relating to the trustees' powers after taxpayer's death. (R. 100, 102–103.) In 1936, taxpayer added insurance policies on his life to the corpus of each trust, but during the taxable years furnished the trusts with funds to pay the premiums. (R. 102.)

Taxpayer's sons were minors throughout the taxable years. In each of the taxable years the trust income was accumulated and added to corpus, and no part of the trust estate was dis-

tributed. Taxpayer was amply able to provide for the support of his sons and did so out of separate funds. (R. 100–101.) The co-trustee bank kept possession of the trust property and the books of account. With rare exceptions taxpayer followed the bank's suggestions regarding administrative matters. As to investments, the practice of the bank was to make suggestions to taxpayer who either approved or made counter-proposals. (R. 103.)

ARGUMENT

The court below correctly affirmed the Tax Court's decision, sustaining the Commissioner's determination, that the income of the trusts was taxable to taxpayer under Section 22 (a) of the applicable Revenue Acts, *supra*. The Tax Court rested its decision primarily upon the powers retained by taxpayer to shift the trust income and corpus as between the sons and the remaindermen, and secondarily upon the other broad powers reserved by taxpayer.

1. Under paragraph 15 of each trust instrument, taxpayer reserved the right in his "sole discretion" to direct payments to his son at any times and in any amounts "from the net income and/or principal." (R. 98.) Upon the son's death "the trust estate remaining unconsumed" was to vest in a limited class of remaindermen to be appointed in the son's will, with remainders over in default of such appointment. (R. 98–99.)

Taxpayer thus had the right to apportion the corpus, as well as the income earned during the taxable years, as between the primary beneficiary and the remaindermen.[3] Only to the extent that he directed distribution to the sons would they receive any part of the trust funds; the "unconsumed" balance would go to the remaindermen. Indeed, under the plenary powers reserved to himself in paragraph 15 taxpayer could choose to terminate either trust at any time by directing distribution of the entire corpus to the son, and thereby cut off the interests of the remaindermen. The power to shift income among the natural objects of one's bounty represents perhaps the most important attribute of ownership. In harmony with the principles enunciated by this Court in *Helvering* v. *Clifford,* 309 U. S. 331, it has repeatedly been held that a settlor who retains such a power remains the substantial owner of the trust property for tax purposes.[4] Where, as

[3] The sons' right to receive the *income* became fixed under paragraph 15 only after they reached majority; during their minority, which embraced the taxable years (R. 100–101), taxpayer could elect either to distribute the income to them or add it to corpus. All of the income for the taxable years was in fact accumulated and added to corpus. (R. 101.) As for the *corpus*, taxpayer had the right at any time—before and after the sons attained majority—to direct distribution to the sons, or withhold it from them and thereby shift it to the remaindermen.

[4] See, e. g., *Stockstrom* v. *Commissioner*, 148 F. 2d 491 (C. C. A. 8th), certiorari denied, 326 U. S. 719; *Brown* v. *Commissioner*, 131 F. 2d 640 (C. C. A. 3d), certiorari denied,

here, he has retained the right to change the devolution of both the income-producing corpus and the income earned during the taxable years, the income is unquestionably includible in his gross income. This feature alone was sufficient to warrant the Tax Court's decision.

There is no merit in taxpayer's contention (Pet. 3, 6; Br. 12, 25–26) that the Tax Court's interpretation of paragraph 15 is contrary to that of the Circuit Court of Appeals in its original opinion, as is apparent from an examination of the pertinent portion of that opinion (R. 142–143). To so contend is to negate any effect to that court's remand of the case to the Tax Court for the purpose of determining the applicability of Section 22 (a), its subsequent affirmance of the Tax Court's decision, and its denial of taxpayer's petition for rehearing.

2. In reaching its decision the Tax Court also relied upon the "other broad powers" re-

318 U. S. 767; *Edison* v. *Commissioner*, 148 F. 2d 810 (C. C. A. 8), certiorari denied, 326 U. S. 721; *Commissioner* v. *Buck*, 120 F. 2d 775 (C. C. A. 2d); *Hyman* v. *Nunan*, 143 F. 2d 425 (C. C. A. 2d); *Miller* v. *Commissioner*, 147 F. 2d 189 (C. C. A. 6th); *Steckel* v. *Commissioner*, 154 F. 2d 4 (C. C. A. 6th); *George* v. *Commissioner*, 143 F. 2d 837 (C. C. A. 8th); *Helvering* v. *Elias*, 122 F. 2d 171 (C. C. A. 2d), certiorari denied, 314 U. S. 692. In the case of a family trust "the possession of such a power is conclusive" in marking the grantor the substantial owner of the trust property (*Hyman* v. *Nunan*, *supra*, p. 428), for it is "chief" among the "satisfactions which are of economic worth" (*Commissioner* v. *Buck*, *supra*, p. 777).

tained by taxpayer. (R. 104.) Taxpayer appointed himself and a bank as trustees, and reserved the right at any time to remove the bank and substitute another. (R. 97.) Although he and the bank were to act unanimously, they were not to be liable, except for fraud or bad faith, for "any action taken in which one of the Trustees does not consent or approve". (R. 35–36.) They were empowered, among other things, to vote any stock in the trusts,[5] to make investments without regard to statutory or judicial limiations upon trust investments,[6] to manage the trust estate as if they were the absolute owners, to make loans to or purchase assets from taxpayer's executors in order to facilitate payment of his estate taxes, and to pay out of corpus premiums on policies insuring taxpayer's life. (R. 97–98, 100.)[7] Taxpayer further reserved to himself the right to enlarge the powers of the trustees. (R. 99.) These broad manage-

[5] Taxpayer was the president, a director, and the largest single stockholder of the corporation whose stock comprised the original corpora of the trusts. (R. 96–97.) About two-thirds of the shares were sold in 1936, however, and no further sales or purchases were made during the taxable years. (R. 100.)

[6] With respect to investments it was the practice of the bank to make suggestions by letter to taxpayer, who either approved or made counterproposals. (R. 103.)

[7] In 1936 taxpayer added insurance policies on his life to the corpus of each trust, but during the taxable years he furnished the trusts with funds to pay the premiums. (R. 102.)

ment powers, especially when viewed in conjunction with taxpayer's absolute right to change the co-trustee and the provision exonerating either trustee of liability for any action it dissapproved, constitute in the aggregate a bundle of rights sufficient to justify the Tax Court's treatment of taxpayer as the substantial owner of the trust property. *Helvering* v. *Clifford, supra; Byerly* v. *Commissioner,* 154 F. 2d 879 (C. C. A. 6th), certiorari denied October 14, 1946; *Stockstrom* v. *Commissioner,* 148 F. 2d 491 (C. C. A. 8th), certiorari denied, 326 U. S. 719; *Miller* v. *Commissioner,* 147 F. 2d 189 (C. C. A. 6th). Certainly when the controls retained by taxpayer over distribution of the corpus and income are added to those retained over administration of the trust, the evidentiary support for the Tax Court's conclusion is unassailable. Under familiar rules governing the scope of judicial review of Tax Court decisions, reiterated by this Court in the *Clifford* case itself, affirmance of the Tax Court's decision by the court below was clearly proper. In *Dobson* v. *Commissioner,* 320 U. S. 489, 501, this Court cited the *Clifford* case as illustrative of the type in which "the judicial function is exhausted when there is found to be a rational basis" for the Tax Court's decision.

3. The decision below presents no conflict with *Hawkins* v. *Commissioner,* 152 F. 2d 221 (C. C. A. 5th), and *Hall* v. *Commissioner,* 150 F. 2d

304 (C. C. A. 10th), as taxpayer alleges (Pet. 5, Br. 13–19). Each case in this field turns, as it must, on its own facts. In the *Hawkins* case the court noted (pp. 221, 223) that the trustee was under "no control by the settlor", and that the settlor had "no voice in management" and reserved "no power save to alter distributions to named beneficiaries whom he is under no obligation to support or educate." These factors serve to distinguish that case from this one. Taxpayer here not only had a voice in management as one of the two trustees, but could change his co-trustee at will; moreover, the primary beneficiaries of the trusts here under scrutiny were taxpayer's minor sons whom he was obligated to support and educate. The same court which decided the *Hawkins* case refused to consider it controlling in *McCutchin* v. *Commissioner,* 159 F. 2d 472 (C. C. A. 5th), which bears a closer resemblance to the instant case.

In the *Hall* case the settlor retained no power to shift either income or corpus among the beneficiaries, but merely a power to postpone distribution of income to the income beneficiaries. The court reaffirmed (p. 307) the proposition that "the power to shift the income from one beneficiary to another is the realization of economic gain within the statute", and proceeded to point out that the taxpayer there reserved the right "to withhold the distribution of income, but he could not shift

it from one beneficiary to another". Taxpayer here had more than a power to postpone or accelerate the enjoyment of fixed beneficial interests; he reserved a lifetime power to determine how much of corpus and accumulated income should go to his sons rather to the remaindermen. *Stockstrom* v. *Commissioner, supra; Commissioner* v. *Buck,* 120 F. 2d 775 (C. C. A. 2d); cf. *Commissioner* v. *Estate of Holmes,* 326 U. S. 480.

Helvering v. *Clifford, supra,* and *Helvering* v. *Stuart,* 317 U. S. 154, with which taxpayer asserts the decision below is "probably in conflict" (Pet. 5, Br. 19), confirm rather than impugn the correctness of the decision below.

CONCLUSION

The decision below is correct. This case turns upon its particular facts and presents no question calling for further review. There is no conflict of decisions. The petition should therefore be denied.

Respectfully submitted.

GEORGE T. WASHINGTON,
Acting Solicitor General.
SEWALL KEY,
Acting Assistant Attorney General.
LEE A. JACKSON,
HARRY BAUM,
Special Assistants to the Attorney General.

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